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# ECONOMIC NEWSLETTER

## Russian Research Center
## Harvard University

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## ECONOMIC RESULTS FOR THE FIRST QUARTER OF 1991

(Million tons unless otherwise indicated)

| Product | First 1/4 of 1991 Output | 1991 as % of 1990 |
|---|---|---|
| Electricity (bil. kw hrs) | 480 | 101 |
| Oil | 132 | 91 |
| Gas (mil. $m^3$) | 211 | 100.3 |
| Coal | 166 | 89 |
| Steel | 154 | 96 |
| Metal Cutting machine tools (1000 units) | 38.5 | 95 |
| Computer technology (billion rubles) | -- | -- |
| Tractors (1000 units) | 124 | 91 |
| Mineral Fertilizer | 7.9 | 92 |
| Pharmaceuticals (billion rubles) | 2.0 | 105 |
| Paper | 1.5 | 94 |
| Cement | 32.7 | 95 |
| Meat | 2.6 | 86 |
| Sausage products | .9 | 92 |
| Edible fish products | 1.4 | 91 |
| Butter | .3 | 84 |
| Cheese (1,000 tons) | 164 | 86 |
| Wholemilk products | 7.9 | 93 |
| Margarine products (million tons) | .3 | 83 |
| Granulated sugar | 1.2 | 79 |
| Confectionary | 1.4 | 96 |
| Canned foods (bil. cans) | 3.4 | 90 |
| canned fruit/vegs | 2.3 | 93 |
| Mineral Water (million dekaliters) | 28 | 75 |

| Product | First 1/4 of 1991 Output | 1991 as % of 1990 |
|---|---|---|
| Footwear (mil. pairs) | 187 | 89 |
| Television sets (million units) | 2.6 | 101 |
| Refrigerators/freezers (million units) | 1.7 | 100.4 |
| Radios (million units) | 2.2 | 95 |
| Tape recorders (million units) | 1.7 | 109 |
| VCRs (thousands) | 61.2 | 99.3 |
| Sewing machines (thousands) | 440 | 97 |
| Washing machines [million units] | 1.9 | 100.7 |
| Vacuum cleaners (million units) | 1.5 | 108 |
| Furniture (bil. rubles) | -- | -- |
| Motorcycles (thousands) | 255 | 97 |
| Cars (thousands) | 307 | 96 |
| Paper (mil. tons) | 1.5 | 94 |
| Household soap (thousand tons) | 163 | 82 |
| Toilet soap (thousand tons) | 77 | 91 |

## Livestock Herds

(as of April 1st, million head)

| | 1990 | 1991 |
|---|---|---|
| Cattle | 93.3 | 89.4 |
| out of which cows | 28.1 | 27.4 |
| Hogs | 57.9 | 52.9 |
| Sheep and goats | 126.8 | 116.9 |

## More About the Economic Results for the First Quarter

Because the mail from the Soviet Union has become more erratic than ever, we only now have received the April newspapers containing the information about the economic results for the first quarter of 1991. With this new data we can now provide a more detailed description of production figures including tables which were unavailable last month. What is notable is that the economy is in the midst of a steep decline. Electricity generation which used to rise at rates of 5 to 7% a year just barely increased by 1%. Natural gas output is just about constant from what it was during the first quarter of 1990 and as we noted earlier oil extraction is down by 9%. Steel production is down 8% and coal mining was down by 11% and the production of coke by 18%. Since the coal miners began their strike in early March, its impact was only felt for one third of the period. For the month of March alone, however, coal output fell by 18% which means that the marginal rate of decline increased significantly. Similarly coking coal production was down by 32% for the month of March. We also have some information now about April. Again as a consequence of the strike, the output of coal in April was down by 20%. Coking coal was down by almost 40%.

Not surprisingly the shortage of coal had an impact in other sectors of the economy. Thus while the output of rolled metals was down by 7% for the first quarter of the year, in the month of April it was down 18%. Fertilizer output in the chemical industry was down by 15% in April.

The downturn in April continued for other items, even those that were not effected by the coal mining strike. Thus oil extraction remained down by 9% from April 1990.

Apparently the price increases are also having an impact on production. Wholesale prices went up on January 1 and this apparently has led to a drop in demand for tractors. Tractor production as a consequence was down by 11% during the first four months of the year.

Equally and in some ways even more serious is the fact that the production of food products is also declining. For example for the first quarter meat production was down 12%, milk output down 10% and eggs down 8%. As the accompanying table shows, all livestocks herds are down. In the past it was unusual if the herd of one animal or another was down 2%. Now we find that the number of pigs has fallen by 9%. This means that it is going to be all the more difficult to start finding meat supplies from within the Soviet Union itself.

As a reflection of how serious conditions are, an article in *Izvestiia* reports that the deputy chairman of the state statistical commission predicts for 1991 as a whole overall production could be down as much 18 to 22%.

As if the drop in production was not serious enough, prices continued to increase. Wholesale prices which were not directly effected by the retail price increase on April 2, have also continued to climb. During the first quarter of 1991, overall wholesale prices rose by 83%. In April alone, however, they rose by 110%.

Finally the Soviet Union's foreign debt situation continued to deteriorate. Whereas the USSR had $15 billion of currency reserves in foreign banks in early 1990, by the end of the year, they had been "eaten up." Nor has there been any progress in paying back arrears on overdue debt. Since November 1990 it has fluctuated between $3 to $5 billion.

## Putting the Engine on the Cart, or a Story about Tax: Comment on A. Abouchar's Article

By February 1991 it became evident that the Soviet Union's economy had collapsed. In view of this, the central government introduced

a sales tax to raise funds for the depleted budget. In the view of Professor A. Abouchar as reprinted in the May RRC Newsletter, the structure of this tax is similar to the value-added tax approved in Western Europe and widely discussed in the US.

I disagree with Abouchar's interpretation because: 1) the monetary system does not work; 2) the arbitrary prices do not reflect the true value of products; 3) all economic relations between enterprises, regions, republics are increasingly based on barter; 4) a sound system for tax collection is lacking (crucial to any tax). Besides, with the presence of heavy subsidies for so called "planned red-ink enterprises" it is unclear how a state can tax negative value added. It now seems that the main burden of this new tax is carried by new economic structures and the poorest strata of the population: the former because now only the new economic units create value which can be taxed, and the latter because the unique tax level does not eliminate the regressive nature of the tax in respect to income. The exclusion of some significant groups of goods from this tax makes the whole idea useless. The desire of the Russian (and maybe the central) government to introduce the value-added tax (as they see it) by the end of 1991, when the prices will be free in 1992 (in accordance with Pavlov's anti-crisis program) is also unrealistic.

The fact that the Soviet government copied something that already exists in the rest of the world is not sufficient reason to praise Prime Minister Valentin Pavlov and his team for attempts to make decisive economic steps. We first must know what the motivation for such a tax is and what the consequences will be.

It happens, as is usually the case that the Soviet system passed through the optimum (standstill) point like a pendulum. Several years ago no one in the Soviet Union wanted to hear about world economic experience to solve particular economic problems intrinsic to the market systems. Now the pure imitation of or reference to some policy proposed by anyone (especially if he represents a government) is sufficient to receive a standing ovation , either inside the country or from foreign observers. This applies not only to the sales tax proposal, but also the premature approval of an anti-monopoly law.

Blind imitation, especially in the same paradigm of total planning, has not brought and will not bring positive results. A hint of movement is not necessarily progress. To expect positive results from such measures as the sale tax is like slipping into day dreams and expecting that a dilapidated cart supplied with a new powerful engine will reach the next gasoline station without losing its old wheels somewhere along the road. The cart will not reach the station. And being broken on the road, it eliminates the need for a new engine. That is exactly what happened. The tax survived no longer than four months, and its funeral cost the Soviet population hundreds of bushels of rubles, the value of which now can only be measured on a scale.

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Visiting Scholar, Russian Research Center

### Alan Abouchar's Reply

The following replies to your main observations may be of interest:

1. It was never stated that elimination of the deficit would be the result or even was the objective of the new sales tax. (My rough estimate was a 10 - 15% reduction.) It is therefore inappropriate to fault it because the deficit would not have been eliminated.

2. Retraction of the tax does not prove that it was wrong in the first place. The retraction was part of the elimination of a parcel of totally injudiciously conceived retail price increases of up to several hundred percent. (Could anyone have though that this would eliminate the deficit or inflation?

Belorussia, incidentally, had just introduced a wage indexation law, and the rest of the country would assuredly have done likewise.) Eliminating the sales tax was part of the overall restriction. It is quite understandable -- to me, at any rate -- that administrators forced to back down the sledge-hammer approach to price reform would also call back even well-conceived laws like the new sales tax.

3. Numerous products which are disproportionately consumed by low-income groups were to be excluded from the tax. Coupled with the new extremely progressive marginal tax rates on incomes (which anticipate very high income levels which are presumably to result from more private activity), this represents a tax structure which is moving in the right direction. No one, incidentally, can ever prescribe with finality what the rates should be since there is no agreement on what personal welfare of individuals should be, so that it is only directions which can be sensibly talked about.

4. Of course, one wants prices to be meaningful. Isn't it time, though, that critics began to show us in what respects prices are incorrect? I urge you to this challenge. All we have been hearing for decades is that Marxism precludes the rationality for Soviet prices because they are based on cost production, which precludes consideration of utility and scarcity so that there is no interest and there is no reflection of demand. (The contradiction represented by this traditional view and the continual allusion to the existence of high subsidies caused by shortfalls of prices from production costs as proof of irrationality of prices seems to have escaped most discussion.) I have shown over the years that there is an interest-like effect from the wage system as it has developed, that demand is considered in the allocation of common costs, that capital is properly treated as part of the price base through a capital cost allowance. All these are in sharp contrast to the preachments of western microeconomics: there is no interest in its cost calculations (because we deal with physical rather than pecuniary relations); it has waived away common costs and price discrimination thereof; and depreciation of capital is abjured as an accountant's term. No one is arguing that Soviet prices are right all the time; I am saying that there is much less wrong than we customarily suppose and no one should rush headlong to change everything. Incidentally, the recent railroad rate reform was a seriously retrograde undertaking.

5. Of course the traditional banking system in non-functional as a true modern banking system. But legislative steps are being taken to improve it, including provision for a new commercial banking system (which is much more essential to business operation that the overly vaunted stock exchange) and fractional reserve banking. I've heard people object that "it's just law, just paper." My heavens! How would they have you begin?

Alan Abouchar, University of Toronto

**FOREIGN EXCHANGE RATES**
as of 29 May 1991
Quoted in rubles

| | Official Rate | Commercial Rate |
|---|---|---|
| £100 Sterling | 102.31 | 306.93 |
| 100 Aust. Sch. | 4.93 | 14.79 |
| 100 D. Marks | 34.70 | 104.10 |
| 100 D. Guilders | 32.73 | 92.37 |
| 100 U.S. Dollars | 58.85 | 176.55 |
| 100 Fr. Francs | 10.18 | 30.54 |
| 1,000 Jap. ¥ | 4.26 | 12.78 |
| 10,000 It. Lire | 4.66 | 13.98 |
| 100 Swiss Frs. | 40.71 | 122.13 |
| 100 Nor. Kroner | 8.90 | 26.70 |
| 1,000 Bel. Frs. | 16.85 | 50.55 |
| 100 Sw. Kronor | 9.67 | 29.01 |

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